“Rural America is On the Go”
U.S. Cellular Position Paper

Executive Summary

Wireless networks will be crucial to the economic development of rural America. However, rural wireless carriers, such as U.S. Cellular, can only construct those networks with appropriate and fair regulatory policies.

The FCC is now considering "intercarrier compensation," which is how telecom companies pay each other for carrying each other's traffic and completing calls begun on other carriers' networks. There have been various proposals made to the Commission to reform intercarrier compensation, with perhaps the most detailed being that of the Intercarrier Compensation Forum ("ICF"). However, thus far the rural wireless perspective has been largely absent from the discussion. The needs of rural wireless carriers and their customers are not the same as those of rural wireline carriers. U.S. Cellular believes that, in considering intercarrier compensation issues, the FCC should be guided by the following principles:

1. The new system should be rational, clear and relatively easy to administer. Only a system based on "bill and keep" principles will meet that fundamental requirement. As a general principle, telecom carriers and their customers should bear their own costs of transporting calls to other carriers, with appropriate cost-based payments to intermediate "transport" carriers.

2. If a policy decision is made to recognize the "rural difference," that policy should benefit rural wireless as well as wireline carriers. The ICF proposals, for example, provide favored treatment to urban wireless and rural wireline carriers, but disadvantage rural wireless carriers through their proposed compensation systems and a new, wireline-only universal service fund.

3. Rural wireless carriers should not be forced by the new compensation system into an archaic wireline regulatory structure, with its small local calling areas and multiple "rate centers." A bill and keep approach will preserve competitive neutrality with respect to the variously defined service areas of different types of carriers, and will thus serve the interest of rural wireless customers. Any new intercarrier compensation system should not be premised on the need to ensure that rural local exchange carriers will always be guaranteed the same "rate of return" in perpetuity.

What is most crucial is that the FCC keep the focus on what will benefit customers, not legacy carriers.

Rural America is On the Go.

And Rural Wireless Carriers like U.S. Cellular are Here to Help.

Rural America is busy. Busy bringing in the harvest that feeds the world. Busy competing with urban centers for new economic growth to update main streets and town squares. Busy telecommuting to distant jobs. Busy keeping in touch with increasingly mobile family and friends.

Wireless carriers like U.S. Cellular who invest in rural communities help make it happen. From the farmer who can stay connected from the far end of the field, to the businessmen and businesswomen who have access to the same communications services as their urban counterparts, to grandparents able to see photos of their new grandchild instantly, rural wireless carriers help ensure that rural Americans can keep moving while still keeping their connections.

Working hand in hand with rural customers and communities is a unique and rewarding challenge. But our ability to invest, grow and serve in rural communities is dependent on fair regulatory treatment and pro-investment market signals. The intercarrier compensation discussions currently before the FCC are critical to the continued success of rural wireless carriers and their rural wireless customers. Because no matter how strong and vibrant the rural wireline network is – and U.S. Cellular does not minimize the importance of rural wireline service – without an equally robust and wide-spread mobile service, the rural areas cannot offer the same communications options and quality to families or businesses. If that happens, all of rural America will be worse off.

U.S. Cellular is pleased to present these ideas on how to ensure that intercarrier compensation reform helps keep rural America on the go with the help of the rural wireless carriers.

Since the FCC issued its Notice of Proposed Rulemaking in the Unified Intercarrier Compensation Docket in April 2001,[1] there have been numerous proposals brought forth by various groups, each seeking to shape the debate over intercarrier compensation.[2] Unfortunately, not one of these groups has included an important voice in the national mix of communications: wireless carriers with a significant rural footprint. Indeed, none even has one freestanding wireless carrier – urban or rural – signing on to their proposal.[3]

This absence is critical: wireless has been a shining model of successful competition in the communications sector, and rural wireless has provided new options and real competition in even the physically and economically hardest to serve areas of the country.

There can be little dispute that the current system of compensation mechanisms, rates, and subsidies is in need of reform. The current system was developed incrementally as the regulatory regime for different industry segments became less regulated or new modalities of service were developed. The result over time has become a system with different rules and costs based on the type of carriers involved in the call, the size of carriers involved in the call, the regulatory classification of the nature of the call, and other factors that have become less meaningful as services have evolved in ways that blur the old distinctions and the marketplace has focused on bundled offerings. U.S. Cellular believes the FCC set the right course in calling for a new and unified compensation system.

With the release of the Intercarrier Compensation Forum ("ICF") proposal,[4] as well as the numerous other proposals that have followed, U.S. Cellular – a leading rural wireless carrier – believes it is important for rural wireless carriers to be heard in the debate over intercarrier compensation. Intercarrier compensation and related issues will shape the future of the telecommunications industry for customers, carriers, and regulators. It is essential that the needs of rural Americans and the wireless carriers who serve them be part of the discussion.

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[1] In the Matter of Developing a Unified Intercarrier Compensation Regime, CC Docket No. 01-92, Notice of Proposed Rulemaking ("NPRM"), FCC 01-132, released April 27, 2001.

[2] U.S. Cellular is aware of proposals of varying degrees of detail from the Intercarrier Compensation Forum ("ICF"), the Expanded Portland Group ("EPG"), ARIC, and the Cost Based Intercarrier Compensation Coalition ("CBICC").

[3] Western Wireless, T-Mobile and Nextel all were previously members of the ICF. That they all felt the need to withdraw illustrates the need for rural wireless carriers to independently make their views known. A number of carriers did just that in an ex parte filed Nov. 17, 2004. While U.S. Cellular was not a signatory to that letter, U.S. Cellular agrees with the Nov. 17, 2004, ex parte filing.

[4] Specifically, U.S. Cellular refers to the ICF proposal as contained in its October 5, 2004 ex parte filing at the FCC.

Principles to Promote Rural Wireless Service and Investment

Rural wireless carriers and their customers believe that the following considerations should guide the Commission's decisions regarding intercarrier compensation related issues:

(1) a new system should be unified, simple, rational and reduce administrative and transactional costs;

(2) if a policy decision is made to recognize the differences and difficulties in providing services to rural areas, that policy should benefit rural wireless carriers and their customers as well as rural wireline carriers;

(3) wireless carriers should not be forced into a legacy wireline model – any system must be technology neutral and anticipate, not inhibit, industry evolution; and

(4) the focus should be on what is best for consumers, not for any particular carriers – and specifically, a reformed system should not assure any class of carriers, even rural carriers, a revenue-neutral result or a guaranteed return.

<u>The FCC Was Right All Along: The Benefits of Bill and Keep</u>

In its April 2001 NPRM, the FCC proposed bill and keep as a unified intercarrier compensation regime. Under a bill and keep system, carriers mutually exchange traffic on an "in kind" basis – there are no intercarrier payments for termination. Each carrier simply bills its own customers for service and keeps that as compensation for traffic exchange.

U.S. Cellular believes the FCC's initial position remains the right one. Every other compensation proposal is far more complex – one of the greatest complaints about the present system. Bill and keep has a simplicity that provides benefits to everyone. Because there are fewer "moving parts," there are fewer ways and opportunities to game the system. Legal and administrative costs are reduced because there are no cost studies and cost cases, no extended negotiations and proceedings, less complexity in agreements and fewer rules and regulations. These savings would result in a more efficient industry, and ultimately benefit consumers through better products at lower prices.

Among the major proposals brought forward to date, only the ICF proposal works toward bill and keep as the ultimate goal. In that respect, U.S. Cellular agrees with and supports the goals of the ICF. The ICF proposal, however, takes seven years to get to bill and keep – an eternity in the fast-paced world of communications. During that seven year period the differing rules, changes, and rates are nearly as complex as what the ICF seeks to replace. While U.S. Cellular agrees that some transitional rules may be necessary, the transitional period should be as brief as possible and the interim conditions as simple as possible to quickly and effectively capture the benefits of a streamlined, less-regulatory environment.

The wireless industry as a whole has shown the power of a regulatory "light touch." Under a simplified regime, wireless penetration and use rates have taken off, and consumers have benefitted from vigorous competition, lower per minute rates, and innovative services like mobile text messaging, instant exchange of digital photos, and location-based information services. The numbers show the impressive results: 97% of the US population lives in a county with access to three or more wireless carriers, up from 88% in 2000.[5] More than three-fourths of the US population lives in counties with six or more wireless choices.[6] By the end of 2003, there were over 160 million wireless subscribers, up from 142 million in 2002, and their use of wireless services had nearly doubled from an average of 255 minutes/month in 2000 to 507 minutes/month in 2003.[7] All the while, the rates paid by the customer have been going down – wireless carrier revenue per minute dropped 13% from 2002 to 2003.[8] Results like these should be the goal for the entire communications sector.

Wireless is Rural, Too

While U.S. Cellular believes the ideal system of intercarrier compensation is a consistent and truly unified system, U.S. Cellular also understands the strong pull of the concerns about rural, low-income, and high-cost areas of the country. U.S. Cellular is based in the Midwest; our heart and soul are in rural America. Since the communications revolution took off, there has been an appropriate and persistent concern among policy makers about the "digital divide." U.S. Cellular has faith in the power of simplicity and uniformity: ultimately, we believe that a pure bill and keep system will best serve rural customers as well as more urban customers. Nonetheless, U.S. Cellular understands the desire to minimize any risk that changes in the intercarrier compensation system may adversely impact the digital divide. It may be that – particularly in the transition period – special considerations should be given to the differences and difficulties in serving a predominantly rural customer base.

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[5] See Ninth Report on Competitive Market Conditions With Respect to Commercial Mobile Services, WT Docket No. 04-111, FCC 04-216, released Sept. 28, 2004 ("Ninth Report") at Appendix A, Table 10.

[6] Id. Even in rural areas, the average number of wireless competitors is five. See Ninth Report, Appendix A, Table 6.

[7] Ninth Report at ¶ 5.

[8] Ninth Report at ¶ 171. The average revenue per minute has dropped 79% since 1994.

What U.S. Cellular does not understand, and does not agree with, is why the current proposals (including the ICF proposal) address this issue from a purely wireline perspective. The difficulties in providing rural service stem largely from low population densities and the inability to spread high infrastructure costs across a significant number of customers. This phenomenon, however, is equally applicable to wireless carriers. Rural customers deserve the same wireless services as urban customers, but providing that equality comes with higher costs. U.S. Cellular and certain other wireless providers took substantial risks in the earliest days of the commercial wireless industry in targeting not the population centers, but the rural parts of the country. Our cellular licenses, as opposed to the more recent PCS licenses that represent the majority of many wireless carriers' spectrum, included more extensive geographic build-out requirements. We took a major investment risk in uncertain markets. Today, U.S. Cellular's largest markets are Wisconsin and Iowa, and we also have significant coverage in Oklahoma, rural central Missouri, rural Oregon, Maine, and West Virginia, as well as similar rural areas throughout the country.

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In recognition of the similar risks and difficulties faced by rural carriers of all kinds, any special consideration of rural areas should provide similar benefits to all rural carriers and their customers, wireline and wireless alike. To favor wireline, or disfavor wireless, creates a disincentive for wireless investment in rural areas. That would be a tragic mistake: in many places, wireless is the most efficient "last mile" technology and may be the only real competitive choice a rural customer will have.[9] Nonetheless, under the ICF proposal rural wireless carriers are among the most disadvantaged carriers. The ICF proposal actually treats rural wireless carriers worse than urban wireless carriers. This occurs in two ways: the ICF's new universal service funds, and in routing and rating protections for rural ILECs.

Our Concerns With the ICF Universal Service Proposals

The ICF proposal makes three major changes to the universal service regime. First, the ICF proposal suggests a number-resources based assessment. There is little question that one purpose is to shift more of the burden of funding USF to wireless carriers. Because that

[9] The FCC appears to have recognized the importance of rural wireless as well. See, e.g., Facilitating the Provision of Spectrum-Based Services to Rural Areas, Report and Order and Further Notice of Proposed Rule Making, WT Docket No. 02-381, released September 27, 2004. In that Order, the FCC made spectrum more accessible in rural areas, relaxed ownership and financing rules, increased the permissible transmission power for rural antennas, among other changes for the purpose of encouraging additional rural wireless service.

is an issue that is not unique to rural wireless carriers, U.S. Cellular will not focus on that aspect of the proposal; we understand that wireless should pay its fair share and our primary concern on the assessment side of the equation is that all sectors of the industry, including IXCs without numbering resources, resale or PRI-based carriers (and others who obtain numbers from another carrier), and Internet-based services should all bear some responsibility for ensuring support for service to all customers. The policy interest is simple: all carriers, regardless of type, who obtain revenue from end-user customers should help support services to those customers. We also believe that since it is customers who ultimately pay the fees to support a USF system, caution should be taken to ensure that those fees are as small as possible and that the assessment system does not create distortions in the market. Along these lines, U.S. Cellular is concerned that wireless customers may be hit hardest by a number-based assessment because many customers have multiple wireless phones on a single account (family plans and share-talk type plans) and the aggregation of fees could become significant for such users. The use of assigned numbers as an assessment mechanism is arbitrary and will not apply in a competitively neutral manner across the industry.

The second and third changes the ICF proposes are the creation of two entirely new universal service funds. As we understand the proposal, one of the new funds – the Intercarrier Compensation Recovery Mechanism ("ICRM") – would provide for the first time access to USF for RBOCs and, by extension, competitive carriers operating in the RBOC territory, including wireless carriers. The second new fund – the Transitional Network Recovery Mechanism ("TNRM") – would be available only to rural wireline ILECs and certain wireline CLECs operating in the rural ILEC's territory. It is expressly denied to wireless carriers.

The result is that rural wireless carriers are relatively worse off than either their rural landline competition or their urban wireless colleagues. . . [The] response to such a system will be a movement of wireless investment from rural areas to urban areas

The anomalous result of the ICF proposal would be that all wireless carriers pay more into the USF system, but wireless carriers with urban footprints are eligible to take more of it back out than wireless carriers with rural footprints. At the same time, rural wireline carriers obtain new support – some of which is funded by increased payments from wireless customers – that wireless carriers cannot obtain. The result is that rural wireless carriers are relatively worse off than either their rural landline competition or their urban wireless colleagues. The economically rational response to such a system will be a movement of wireless investment from rural areas to urban areas. Such a system will almost certainly aggravate the digital divide instead of remedying it – turning the very purpose of a USF upside-down.

Our Concerns With the ICF Traffic Exchange Proposals

A second competitive distortion is caused by the ICF's routing and rating protections for rural wireline LECs. Under the ICF proposal, unique interim and permanent rate structures are proposed to give those rural carriers additional revenue streams that will ultimately be removed from all other carriers. Along with these unique revenue streams, the "network edges" are different for rural wireline carriers than for other carriers, as are rules for which party is responsible for transport payments.

The best example is a land-to-mobile call. A call from a non-rural wireline network to a wireless network is a traditional bill and keep call: no intercarrier compensation occurs; the originating network is responsible for the cost of providing service and obtains its compensation from its own end user customer. In the case of a similar call from a rural wireline customer to a wireless customer, however, the wireless carrier would have to pay a portion of the rural LEC's outbound transport. Again this creates two problems. First, a wireless carrier with a predominantly urban footprint conducts fewer transactions under these rules than a more rural wireless carrier, creating a competitive advantage for the urban wireless carrier (and providing incentives for new wireless investment to be in urban rather than rural areas). Second, the rural wireless carrier is already facing the same types of effects from serving low-density populations as the rural landline carrier, and under the ICF proposal has to bear not only its own burden in that regard but also – through these pass-through mechanisms – the burden of the rural wireline company.

There is no policy justification for the rural wireless carrier to have "double taxation" of the costs of serving low density areas. Such a regime will result in fewer choices for rural customers and less investment in innovations in rural areas versus urban areas.[10]

<u>If it Isn't Broken, Don't Fix It: The Wireless Model is Working</u>

Compare the results of wireless competition with wireline competition. Most areas of the country now have more choices among wireless providers offering similar packages than they do among landline LECs offering similar packages – despite the relative youth of the wireless industry. While total ILEC access line counts are level or actually decreasing, and CLEC market share has largely flattened out, wireless penetration and minutes-of-use

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[10] U.S. Cellular recognizes that a bill and keep solution must also consider the situation, common in rural areas, where a third party transits the call between the originating and terminating network. In that scenario, U.S. Cellular agrees that the transiting carrier is entitled to reasonable, cost-based compensation. U.S. Cellular also notes that between the August 16 ICF ex parte and the October 5 ICF ex parte, the ICF recognized the presence in Iowa and Minnesota of rural LEC controlled centralized equal access providers. U.S. Cellular believes this change is an important improvement in the ICF proposal that will make network "edges" in these rural states more rational.

growth continue to climb. Arguably, landline competition is decreasing: AT&T and Z-Tel have both announced a pull-out from traditional residential telephony competition; MCI, McLeod and others have been through bankruptcy. There has been very little litigation between wireless carriers while ILECs and CLECs have litigated virtually without pause since 1996. No rational decision maker would look at the results of the wireless versus the wireline framework and suggest that consumers or the competitive and investment marketplaces would be improved if only wireless carriers followed the wireline model. Yet that is precisely what most of the intercarrier compensation proposals, to varying degrees, suggest.

One of the most significant differences in the wireless and wireline models is the size of the local service territory. The wireless model is based on significantly larger local service areas or, to put it in wireline terms, fewer "rate centers." A smaller number of rate centers provides a variety of benefits both to the consumer who has the larger local calling area and to carriers because the reduced number of boundaries results in a simplified system with lower administrative and transactional costs. Most of the intercarrier compensation plans presented, however, force wireless carriers into compensation regimes based on smaller geographic units tied to the rate centers, exchanges, or service territories of the underlying wireline LECs. This artificially increases the rates that wireless customers have to pay, and actually penalizes wireless carriers for offering something more to customers.

There are two ways to avoid this result -- two ways to move towards the more successful wireless model instead of moving wireless carriers away from what has worked so well. The first would be to force the wireline carriers into the wireless regime. This would be a technically and politically daunting task involving massive rate center consolidation and serious economic disruptions for those facing such dramatic changes. The second, easier, more sensible solution is to simply develop a compensation regime that is competitively neutral with regard to the size or number of local territories. Pure bill and keep does precisely that.

> ***Nearly every deviation from bill and keep is for the express purpose of honoring the local boundaries of some carrier . . . inevitably creating inefficiencies and more important they inescapably pick winners and losers. . .***

Nearly every deviation from bill and keep is for the express purpose of honoring the local boundaries of some carrier or class of carriers, losing sight of the customers. The decisions to make such deviations, however, inevitably create inefficiencies and, more important, they inescapably pick winners and losers in each transaction. Such decisions include: Do you choose the boundary of the smallest territory involved or the largest? Do you use the exchange boundary as the "edge" (as the ICF proposal does for most carriers) or the central office (as the ICF proposal does for rural wireline carriers)? Each of these decisions creates market distortions without any consistent, principled policy basis – they are all relatively arbitrary decisions, based on hunches and politics, however well intended. Bill and keep presents the smallest number of such decisions, and as a result the smallest number of opportunities for market distortion. As a result, bill and keep is the most business-model neutral and boundary neutral intercarrier compensation regime. It is the only way to avoid imposing a costly regulatory "fix" on a wireless industry that is not broken.

The Customer Always Comes First

The most important principle of all – and surely the one that most often gets lost in intercarrier disputes – is that the customer should be the focus of both industry and regulatory decisions. Imposing new costs on rural wireless service will result in higher costs for customers. Disincentives for rural wireless investments will result in less choice and less robust coverage for rural wireless customers and rural communities.

Keeping customers in mind, the foremost rule when reforming intercarrier compensation should be "first, do no harm." Calling areas, costs, and competitive choices for customers should be improved where possible, but above all should not be made worse. Less directly, market signals should not create undue distortions – rules should be competitively and technologically neutral, incentives should move carriers towards more efficient and successful business models, investment and innovation should be encouraged – particularly where it has been lacking or where natural barriers exist. Non-productive costs like administration, litigation, and transactional "friction" should be diminished to the greatest extent possible. Simplicity is a valuable goal, both for an efficient intercarrier system and for customer understanding of their bills and their service choices.

Bill and keep satisfies these principles. Driving out implicit subsidies and creating more transparent market signals moves towards these principles. Making USF a single, unified program with a simple "everybody pays a little" approach serves these principles. Better still is to ensure that the USF subsidy remains fully portable so it is based on the consumer and is fully modality neutral.[11] Promoting innovation – not reinforcing legacy approaches – ultimately brings new and better services to customers.[12] Raising some customer rates to ensure that a particular carrier or business model flourishes is the wrong approach. The customer – not the carrier – should be focus of compensation reform.

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[11] Full portability of any subsidy also must be paired with elimination of other barriers to customer choice. It is critical that all waivers and suspensions of intermodal number portability are allowed to expire or are vacated as part of compensation reform. All customers – including rural customers – should have the largest number of communications options with the fewest barriers to their choices.

[12] In this regard, U.S. Cellular agrees with the September 2, 2004 ex parte filing of the CBICC with the FCC, which noted that the ICF's definition of and treatment of "hierarchical" and "non-hierarchical" networks discriminates in favor of legacy networks.